Testimony of Michael Sussman, Strategic Rail Finance

Subcommittee on Railroads, Pipelines and Hazardous Materials

"Sitting on Our Assets: Rehabilitating and Improving our Nation's Rail Infrastructure."

Thursday, February 17, 2011 at 10:00 a.m. in 2167 Rayburn House Office Building

Good Morning, Chairman Shuster and Members of the Subcommittee. My name is Michael Sussman. I own Strategic Rail Finance, a company I founded seventeen years ago after I discovered that most freight railroads, for no inherent business reason, have fewer funding options than companies that are much less important to the nation. I have coordinated financing for rail projects in 23 states, inventing new ways to integrate private-sector financing with public-sector funding. This collaborative approach delivers more capital and strengthens rail projects for all stakeholders.

I have been asked by the committee staff to provide my perspectives on the Railroad Rehabilitation and Improvement Financing program, or RRIF. The RRIF program is a USDOT loan and loan guarantee program with three main attractions. One is the repayment term which can be as long as 35 years. Second, is its relatively low interest rate based on Treasury securities of a similar term. Most importantly, it recognizes the collateral value of track, right-of-ways, and transportation facilities, assets for which it is challenging to secure long-term private-sector financing.

The country can enjoy a substantial return from improving the RRIF program. In spite of America's love-hate relationship with railroads, rail transportation provides many public benefits. Each trainload of freight, if moved on our highways, requires a convoy of trucks 27 miles long. Since those trucks burn two to four times the amount of diesel fuel the consequent increase in air pollution is significant. We need trucks as part of a complete transportation system, but we need increased rail transportation more than ever.

RRIF fulfills a role that is missing in the private sector. Since federal deregulation of railroads in 1980, the number of short line and regional railroads has increased from 190 to 575. At the same time banks have merged and consolidated, leaving behind the close connection between local banks and local railroads. In spite of the long-term financial stability of rail projects, they are more challenging to finance than riskier commercial developments such as office buildings and movie theatres.

So why has does this $35 billion loan program still have $34.6 billion available and what can be done to increase the loan activity? I will suggest four no-cost remedies and several process improvements.

Firstly, I recommend enforcing the previously mandated 90-day timeline for the FRA to make loan decisions.

Secondly, I would like to see the OMB reverse the practice of cutting the collateral values by 20% when accompanied by professional appraisals. Hardly warranted when the primary assets presented in rail projects, i.e., steel, land, and rolling stock are among the most stable collateral items we see, often appreciating in value over time.

Thirdly, it is vitally important to revisit the FRA’s de-prioritization of refinancing made public last September. There should be no reluctance to approve RRIF funds for refinancing as long as it supports a comprehensive capitalization strategy for successful long-term stewardship of rail facilities.

Fourth, borrowers should be given the option of a higher interest rate in exchange for a lower credit risk premium.

There are other ways to improve the RRIF program such as instituting a clear pathway for the program’s loan guarantee function and coordinating with state departments of transportation and local banks. I would be gratified to share these ideas with the committee at a later date.

For now, just a brief mention of process improvements.

Seeing a RRIF loan application through to completion is like raising a child. No one really talks about how damn hard it is and even if they do, it is harder than anyone has the capacity to imagine until they have one of their own.

What I would like to see is a less expensive, less strenuous application process for smaller RRIF loans in support of one of its stated purposes, “Preserve or enhance rail or intermodal service to small communities or rural areas.” As an addendum to my remarks, I have provided data on the outstanding repayment history of state revolving loan funds that rely on much less application information and a relatively rapid approval process.

The RRIF process needs to be more predictable and more interactive. Applicants need more coaching and support at every stage and the application itself needs to be rewritten by writers, not financial analysts or engineers. Many of the application questions do not clarify the level of data and detail required and the FRA is often muted in its response to inadequate applications. This communication gap adds weeks and months to the process, often ending in frustration and withdrawn applications.

Relating to a much simpler state loan application, Kathleen Grover, former administrator of Michigan’s rail loan program said that 50% of the applicants did not respond to requests for additional information. Railroaders are some of the hardest working people in industry. A successful RRIF campaign requires more determination and communication than most rail operators can muster.

My addendums also include a side-by-side comparison of USDOT’s RRIF and TIFIA finance programs that you may find helpful during your continued analysis. For that, I thank Joe Pomponio, the former director of the RRIF program, and Bryan Grote and David Seltzer of Mercator Advisors, two of the primary developers of the TIFIA program.

If we apply our limited public resources intelligently, we can seed private-sector investment to accomplish goals that neither sector can achieve on their own. The resulting innovation can provide the capital environment for railroads to substantially increase their contribution to America’s economic vitality. Thank you for this opportunity to present my views.

Addendum A:

The large railroad bankruptcies of the 1960's and 70's that occurred before deregulation in 1981, created a debilitating mythology about the stability and creditworthiness of railroads. Over the last thirty years, misperceptions notwithstanding, Class II and III railroads have been stable, growing business entities with an outstanding record of repayment to banks, suppliers, and government loan programs. For example, the SBA experienced zero defaults and zero losses from any of their 15 loans to railroads, totaling $6.4 million between fiscal year 1988 and fiscal year 1997. We track the loan repayment history of seven states that have revolving rail loan programs. Between 1993 and 2007, $263 million of loans to 404 projects were administered without a default.

STATE RAIL LOAN PROGRAM REPAYMENT HISTORY

STATE OR AGENCY	NUMBER OF LOANS	DOLLARS LENT	DEFAULTS
Wisconsin 2004*	70	$70,000,000	0
Michigan 2004	26	$11,700,000	0
Iowa 2005	57	$46,370,000	0
Minnesota 1999	120	$74,000,000	0
Kansas 2007	41	$12,903,380	0
Mississippi 2007	35	$12,000,000	0
Ohio 2007	40	$30,000,000	0
SBA 1999	15	$6,400,000	0
TOTALS (*last year data gathered)	404	$263,370,000	0

Close investigation of the financial history of Class II and III railroads over the last twenty years reveals the low incidence of small railroad bankruptcies. The relatively few closures that have occurred transpire as what we consider "organized closures". In other words, they go out of operation in stages, paying down creditor balances to zero as demand for rail service on their line declines.